RECENT DEVELOPMENTS

RATE COMPETITION BETWEEN RAILROADS AND OTHER MODES OF TRANSPORT

Interstate Commerce Commission v. New York, New Haven and Hartford Railroad Co.
372 U.S. 744 (1963)

Sea Land Service, Inc.,[1] a water carrier operating principally between ports on the Atlantic Coast and the Gulf of Mexico, proposed lowered rates on 489 movements[2] after substantially reducing its operating expenses by converting from break-bulk to containerized motor-water-motor[3] carriage: the Interstate Commerce Commission, Division 2, permitted the bulk of these rates to become effective.[4] Southwestern and eastern railroads, despite an admonition by Division 2,[5] thereafter filed lowered rates on selected trailer-on-flatcar (TOFC) commodity movements from points in the east to Dallas and Fort Worth; these rates were roughly on a parity with the new Sea Land rates and were intended to provide increased rail competition for the traffic moving by Sea Land.[6] The ICC investigated the proposed rail rates and found, first, that the rates would prove compensatory to the proponents, in that they generally exceeded out-of-pocket costs and in many cases exceeded fully-distributed cost,[7] and, secondly, that the rates were the vanguard of an army of contemplated reductions which would threaten the continued existence of the coastwise water carriers.[8] Although the Commission discussed the relative costs of the competing modes it did not determine where the inherent advantages of the carriers lay as to any of the rates in issue.[9] In applying the rule of ratemaking to its findings the

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[1] Formerly Pan-Atlantic Steamship Corporation: the name was changed on April 1, 1960. Commodities—Pan-Atlantic Steamship Corporation, 313 I.C.C. 23, 25 n. 3. (1960).

[2] Commodities—Pan-Atlantic Steamship Corporation, 309 I.C.C. 587, 597 (1960).

[3] Sea Land's containerized carriage amounted to transportation of loaded trailers minus their motor cabs. For informational material on containerized carriage, see 73 Interstate Commerce Commission Ann. Rep. 64; (1959); 76 Interstate Commerce Commission Ann. Rep. 110; (1962); Fox, "Trailer on Flatcar Rates," 28 I.C.C. Prac. J. 833 (1961).

[4] Commodities—Pan-Atlantic Steamship Corporation, 309 I.C.C. 587, 597 (1960).

[5] *Id.* at 606.

[6] Commodities—Pan-Atlantic Steamship Corporation, 313 I.C.C. 23, 34 (1960).

[7] *Id.* at 44.

[8] *Id.* at 47. The Commission noted that the rail rates might, if approved, "precipitate a cycle of destructive competition." *Id.* at 41. This would seem to indicate that the threatened destruction, if possible, was at least not imminent, and that the carriers by water had the will, if not the wherewithal, to continue to compete.

[9] *Id.* at 46.

Commission determined that the National Transportation Policy [10] (hereafter referred to as the NTP) embodied in section 15a(3)[11] outweighed that section's mandate of increased competition and concluded that the proposed rate reductions must be forbidden as violative of the NTP's proscription of destructive competition and its encouragement of a transportation system adequate to meet the needs of the national defense. In concluding that destructive competition obtained in a situation in which a carrier's traffic was competitively threatened, regardless of that carrier's intrinsic fitness to carry that traffic, the Commission endorsed a rationale which "reflects acceptance of 'umbrella' ratemaking under almost any definition of that term." [12]

On appeal the district court set aside the Commission's order and enjoined the cancellation of TOFC rates which returned the fully distributed costs of carriage.[13] The Supreme Court vacated the district court's judgment, set aside the Commission's order and remanded the proceedings to the Commission.[14] In substantial agreement with the lower

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[10] The National Transportation Policy, 54 Stat. 899, 49 USC preceding § 1, provides:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

[11] 72 Stat. 572; 49 USC § 15a(3):

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

[12] Harbeson, "The Regulation of Interagency Rate Competition Under the Transportation Act of 1958," 30 I.C.C. Prac. J. 287, 300 (1962).

[13] New York, N. H. & H. R.R. v. United States, 199 F. Supp. 635, 646 (D. Conn. 1961). This decision is discussed in Harbeson, *op. cit. supra* at 299, and in 110 U. Pa. L. Rev. 1168 (1962).

[14] Interstate Commerce Commission v. New York, N. H. & H. R.R., 372 U.S. 744 (1963). The decision will hereinafter be referred to as *New Haven.*

court, the Supreme Court held that "on the present record, the disallowance of the rates in question was not adequately supported" [15] by relevant findings, due to the absence of a finding concerning the inherent advantages of the proponent and protestant carriers. "When the court's view of law or policy differs from that of the agency, the agency's findings often fail to answer the questions the court deems crucial, and the only proper disposition the court can make of the case is a remand to the agency so that the needed answer can be supplied." [16] In the instant case the court's construction of section 15a(3) differed radically from the agency's: the Commission appeared to consider the desiderata of the NTP as paramount within the rule of ratemaking and applicable to the findings at hand; the Supreme Court viewed the NTP as subordinate in the context of the statute and inapposite to the Commission's findings. In the Court's view only an additional agency finding of some inherent advantage in the protestant carrier threatened with destruction could have rationalized the Commission's suspension order and made it conformable to the rule of rate making; destruction of a carrier with no irreplacable advantage was considered not to be within the NTP's proscription.

Thus the narrow or unavoidable holding of *New Haven* is that the ICC cannot in an intermodal rate controversy rely upon the NTP's proscription of destructive competition in suspending a proposed compensatory reduction absent a finding of an inherent advantage in the threatened carrier. However, the broader importance of the decision lies primarily in the Court's illumination of the extent to which the NTP "qualifies and limits the freedom of intermodal rate competition" [17] and secondarily, in the tentative judicial approval extended to fully-distributed costs as the proper criterion for establishing the crucial cost-of-service advantage in future intermodal rate controversies. The disclosure of the extent to which the NTP modifies competitive freedom was developed in the authoritative exegesis of section 15a(3); the Court's distribution of emphasis is general, reasonable and comformable to the underlying legislative intent, and it is to be hoped that the emphasis prescribed will be controlling in future cases. The tentative judicial approval of fully-distributed costs emerged from the Court's commentary on destructive competition, and although it has been adopted as a currency of convenience in a few recent ICC rulings, the Court probably will not use it as precedent.

Section 15a(3) in its present form is the result of legislative compromise [18] and was from its enactment the subject of conflicting interpretations. Under the heretofore prevailing view, section 15a(3) merely codified the balance between competition and control which inhered in the ICC

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[15] *Id.* at 761.

[16] 2 Davis, Administrative Law Treatise 436, § 16.01, (1958).

[17] Fulda, Competition in the Regulated Industries—Transportation 369, § 11.11 (1961).

[18] Fulda, *op. cit. supra* at 360; § 11.8; 104 Cong. Rec. 10859 (1958) (remarks of Senator Smathers); 104 Cong. Rec. 10857 (1958) (memorandum of Senator Kefauver); Surface Transportation Subcommittee of the Committee on Interstate and Foreign Commerce, "Stewardship of the I.C.C.," 86th Cong. 1st Sess., 15 (1960).

decisions preceding it;[19] however, spokesmen for railroad interests read the section as putting primary emphasis on managerially created competition.[20] Members of the ICC espoused conflicting views in off-the-record analysis,[21] although Commissioner Freas before Congress said of the Commission, "It understands also that as a result of this amendment, the principal emphasis, but not the exclusive emphasis, in a competitive ratemaking proceeding involving different modes will be on the conditions surrounding the movement of traffic by the mode to which the rate applies." [22] Nevertheless, the amendment as enacted apparently had no practical effect on the Commission's decision making process.[23] The amendment as interpreted by the Supreme Court has.

The Court's interpretation of section 15a(3) settles at least the major aspects of the dispute over the intent effectuated by the statute: for future decisions emphasis is to be placed primarily on the "clear congressional design" [24] embodied in the first clause, secondarily on the "more particularized mandates of the National Transportation Policy" [25] and only finally on the "broad policy factors" [26] in the NTP. The legislative intent embodied in the first clause is the intent to encourage intermodal competition, to permit each mode to assert its inherent advantages of cost and service, and to foreclose agency paternalism. This fostering of competition is modified by the NTP only to keep hard intermodal competition from becoming destructive. The Court determined that hard competition obtains when one carrier takes traffic from another by asserting an inherent advantage; destructive competition when one carrier takes traffic from another mode by preventing that mode from effectively asserting its inherent advantages.

The Court defined destructive competition thus generally, leaving that term to be filled with meaning by the agency's future quasi-judicial

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[19] Panel, "Revised Rule of Ratemaking," 26 I.C.C. Prac. J. 1146, 1158 (1959); Morton, "Let's Examine a Chestnut—Another Look at the Rule of Ratemaking," 28 I.C.C. Prac. J. 345 (1960); Schenker, "The Rate-Making Powers of the I.C.C.," 65 Pub. Util. Fort. 649, 650 (1960).

[20] Langdon, "A Railroad View of Section 15a(3), Interstate Commerce Act," 26 I.C.C. Prac. J. 879 (1959).

[21] Address by Commissioner Everett Hutchinson to Annual Convention of Texas Independent Meat Packers Association, August 16, 1958, excerpted in 26 I.C.C. Prac. J. 13 (1958); Address by Commissioner Charles A. Webb to Regular Common Carrier Conference of ATA, October 20, 1959, excerpted in 27 I.C.C. Prac. J. 275 (1959); "Some Aspects of Transportation Regulation," Address by Chairman Howard Freas to Public Utility Law Section of ABA, August 25-27, 1958, reproduced in 62 Pub. Util. Fort. 792 (1958).

[22] "Stewardship of the I.C.C.," *supra* note 19, at 16.

[23] Fulda, *op. cit. supra* note 18, at 369, § 11.11; Harbeson, *op. cit. supra,* note 12, at 304.

[24] Interstate Commerce Commission v. New York, N. H. & H. R.R., 372 U.S. 744, 762 (1963).

[25] *Ibid.*

[26] *Ibid.* The Court concluded that only in "extraordinary circumstances" should the Commission permit broad policy factors such as national defense to shape a decision in derogation of the statute's more specific commands.

inclusion and exclusion. However, in the situations [27] selected to exemplify destructive competition the Court went far toward implicitly underwriting fully-distributed cost as the relevant cost criterion for assigning the crucial cost of service advantage in future intermodal rate controversies. However, the Court wisely qualified its approval in two important particulars [28] and appended a general disclaimer,[29] a deferential bow to the Commission's expertise.[30] The result was that the commentary on fully-distributed cost was left unsettled enough that it may be appealed to in future decisions where predatory rate cutting is patent, but may as easily be avoided in cases where its application would produce a result felt to be unreasonable. This result, alternative adoption and rejection of fully-distributed cost, is observable in microcosm in recent Commission rulings hereafter mentioned.

Although the use of fully-distributed cost to determine the inherent advantage of low cost of service is underwritten by transportation economists and has usually been relied upon by the Commission,[31] there are several cogent reasons for refusing to establish fully-distributed costs as the relevant criterion in all intermodal rate reduction cases. First, although the use of fully-distributed cost tends to maximize carrier revenue by making each movement self-supporting while leaving traffic with the carrier economically most fit to carry it, it also tends to raise prices to shippers in the competitive area [32] without necessarily lowering rates correspondingly in non-competitive areas.[33] Secondly, fully-distributed cost remains an abstraction of which the ICC has correctly said, "There can be no doubt that an apportionment of constant costs to arrive at the fully-distributed cost of a particular movement represents an effort to allocate costs which are essentially, and by definition, unallocable. The Commission's Cost

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27 "And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed cost and thus perhaps to go out of business." *Id.* at 758.

28 The two qualifications are, first, that advantages of cost may be overcome by superiorities of service and, secondly, that advantages of cost may be so overwhelming that competitors' rate reductions may be de minimis. *Id.* at 762, n. 14.

29 *Id.* at 760.

30 The Commission is apparently working on the problem of rate-cost criterion in its hearings on docket number 34013, Rules to Govern the Assembling and Presenting of Cost Evidence. 27 Fed. Reg. 4102 (1962); Interim Report, 321 I.C.C. 238 (1963).

31 I.C.C. Investigation and Suspension Docket number 7656, Grain in Multiple-car Shipments—River Crossings to the South. Report of the Commission on reconsideration (official release, July 15, 1963).

32 *Cf.* Oppenheim, The National Transportation Policy and Inter-Carrier Competitive Rates 62 (1945).

33 Opponents of the use of out-of-pocket costs have often objected that such a criterion throws the burden of defraying a carrier's constant costs upon so-called captive traffic. (Compare cases and commentary in Locklin, Economics of Transportation 435, 1947). It is clear that merely using fully-distributed costs without more does not necessarily free captive, non-competitive traffic from pre-existing rates.

Finding Section has recognized this fact." [34] The most sensible argument leveled against the use of fully-distributed cost is that, like any mechanistic legalism, it simply does not produce the desired and desirable, the reasonable, result in every case: the Commission's opinion on reconsideration in *Grain in Multiple Car Shipments—River Crossings to the South* [35] emphasizes this point.

In *Grain* the ICC found that protestant barge and barge-rail routes had low fully-distributed costs for movements of grain from origins at Ohio and Mississippi River crossings to major grain consuming areas in the South. However, faced with the fact that much of the available traffic was being carried by unregulated competition and would continue to be if rates of regulated modes were held at the level of the lowest fully-distributed cost the Commission permitted proponent rail carriers to reduce rates to a level below protestants' fully-distributed cost so that the railroads could attract shipments then moving by unregulated carriers. The Commission determined that, as a matter of policy, out-of-pocket costs should be the criterion used to determine the inherent cost advantage when a substantial amount of available traffic was being lost to unregulated carriers. However, after justifying a reduction which it considered sufficient to permit the rail carriers to recapture traffic from their unregulated competitors, the Commission significantly required the railroads to raise the proposed rates somewhat so that the impact of the new rate structure on regulated barge competition would be less deleterious.

The reasonableness of relaxing the fully-distributed cost criterion in *Grain* seems obvious. The exempt truckers were apparently carrying grain into the South on backhauls at rates which were probably below their out-of-pocket costs,[36] creating precisely that cut-throat, unstable competitive environment which regulation attempts to prevent. It is clear that in an environment of regulated competition the exempt carriers' short-sighted rate cutting would have constituted destructive competition, deleterious to the initiating carriers, their competitors, their shippers and, ultimately, the public. The Commission benefited shippers by permitting a stable transportation unit to enter the competitive arena created by the exempt modes; moreover, there is a patent equity in the decision that a mode which bears the burdens of regulation and delivers to the public regulation's benefits should not suffer the full adverse effects of competitive tactics which it is prevented from using.[37]

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[34] Grain in Multiple-car Shipments—River Crossings to the South, *supra* note 31, at 23. In the same proceeding one cost witness introduced ten different methods of distributing constant costs over specific movements "with the various methods producing widely varying figures on fully-distributed cost." *Id.* at 30.

[35] *Supra* note 31. Hereafter referred to as *Grain.*

[36] The Commission recognized that the precise level of the exempt truckers' rates was impossible to ascertain since those rates were unpublished and subject to change without notice. *Grain, supra* note 31 at 36. Commissioner Freas observed that the rates had been characterized as "gasoline money." *Id.* at 63.

[37] A significant recent case which merits comparison with *Grain in Multiple-car Shipments* is *Grain from Idaho, Oregon and Washington to Ports in Oregon and*

In *Automobile Lamps and Alcoholic Liquors from Pennsylvania to Texas and Louisiana*[38] the Commission rejected the use of fully-distributed costs on more tenuous grounds. After citing *New Haven* for the proposition that the Commission is authorized to make cost comparisons on the basis of out-of-pocket costs, Division 2 wrote, ". . . the use of out-of-pocket costs as the determinant is especially appropriate where, as here, no other cost evidence has been presented by the parties."[39] However, most of the Commission's recent rulings in which the parties have proceeded successfully beyond the considerable obstacle of the burden of proof[40] have indicated the Commission's willingness to accept full-distributed cost as the usual criterion for determining where the inherent cost advantage lies and, therefore, as an indication of where destructive competition obtains.

It is still somewhat early to predict the total impact of the *New Haven* decision on the disposition of protested rate reductions by the Commission; it has been said that the conflict between hard competition and destructive competition is raised only when the survival of the protestant carrier is threatened,[41] and the question of survival of the protestant carrier for the movements in question has been alluded to, but has not been believably raised in any of the recent rulings. Because survival has not been at issue, the result in recent cases has been that the available traffic was divided between the competing modes and, unfortunately, this result has been supported by language which seemed to indicate that traffic should be shared in accordance with administrative fiat.

Typical of the decisions in which the competitive ideas of *New Haven* are mixed with the language of traffic sharing by regulation is *Steel Bars from Lemont, Illinois, to Iowa, Kansas, Mo., Minn., and Neb.*[42] In that case the Commission relied upon *New Haven,* saying:

Washington, 319 I.C.C. 534 (1963). In the latter proceeding rail carriers established rates below their fully-distributed costs on many grain movements within the Pacific Northwest, forcing competitive regulated barge and barge-motor carriers to promulgate rates below their full-distributed costs in order to remain competitive. Protestant barge-motor carriers proved that they had the advantage of low fully-distributed cost and Division 2 cancelled the limited-transit rail rates. In its ruling the Commission relied entirely upon *New Haven* and distinguished its earlier holding in *Grain in Multiple-car Shipments.*

38 319 I.C.C. 335 (1963).

39 319 I.C.C. 335, 338 (1963).

40 In at least three recent cases lowered rates have been approved because protestant carriers have failed to introduce sufficient cost data to substantiate their claims of inherent cost advantage. Garden Hose and Electric Cable from New Jersey or Rhode Island to Points in Texas, 319 I.C.C. 227 (1963); Intercoastal Any-Quantity Class and Commodity Rates, 319 I.C.C. 357 (1963); Cement Within Southern Territory and from Hagerstown, Md., to the South, 319 I.C.C. 465 (1963). The problem of burden of proof before the Commission is illustrated by Cast Iron Boilers from Boyertown, Pa., to Points in Texas, 319 I.C.C. 319 (1963) in which Division 2 suspended respondent's proposed rates because respondent had not convinced the Division what item of loss and damage expense was properly applicable to the movements in question, but allowed a rate challenged by protestants to remain in effect because protestants' evidence was also incomplete.

41 Fulda, *op. cit. supra* note 18, at 369, § 11.11.

42 319 I.C.C. 292 (1963).

> The record shows that the proposed rates are amply compensatory in that they exceed out-of-pocket costs, and in most instances, fully-distributed costs. To require the respondents to hold their rates at a higher level to protect the traffic of the water carriers would be contrary to the purpose and effect of section 15(a)(3) of the Act.[43]

However, the Commission further observed:

> Under the present level of rates, the respondents are able to attract only 10% of the total annual out-bound tonnage moving from Lemont .... Approval of the reduced rail rates should enable the respondents to obtain a greater share of the available traffic and to increase their revenues. The proposed rates appear to be no lower than necessary to accomplish those objectives.[44]

Despite the fact that language consistent with administratively directed traffic sharing appears in the recent decisions, it is clear that the traffic sharing is occurring because of the carriers' mutual fitness, not because of umbrella ratemaking. The nascent trend in the decisions following *New Haven* is toward more agency tolerance of managerially initiated rate reductions with consequent decreased agency reliance on value of service pricing and the spectre of prospective rate wars to create relatively artificial rate floors. In several cases reopened by the Commission for review in the light of the *New Haven* decision, proposed rail rates, which had previously been refused on the grounds that they had not been shown to be just and reasonable or no lower than necessary to meet competition, have been approved.[45] And, in *Aluminum Articles from Sandow, Texas, to Pennsylvania and New York*,[46] the Commission went so far as to say that ". . . the Supreme Court held that except in extraordinary circumstances not present here, section 15a(3) prohibits holding up rates of one mode to a particular level to protect the traffic of another mode, at least until such rates are reduced below fully-distributed cost, even though the competing mode has the inherent advantage of lower cost." [47] The plea often made by protestant carriers that a proposed rate, although above the proponent's fully-distributed cost, is unreasonable because it is lower

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[43] 319 I.C.C. 292, 303 (1963).

[44] *Id.* at 304.

[45] Garden Hose and Electric Cable from New Jersey or Rhode Island to Points in Texas, 319 I.C.C. 227 (1963), (failure of proof); Wrought Pipe to the Southwest, 319 I.C.C. 310 (1963) (extension of *New Haven* to a proceeding under § 3(1): *but see* concurring opinion therein); Plastics from Texas to the East, 319 I.C.C. 379 (1963); Electric Cable and Wire from Worcester, Mass. to Houston, Tex., 319 I.C.C. 390 (1963); Alcoholic Liquors from New Hampshire and New York to Texas and Louisiana, 319 I.C.C. 396 (1963).

[46] 319 I.C.C. 431 (1963).

[47] 319 I.C.C. 431, 439 (1963). It is at least doubtful that *New Haven* has given managerial initiative such a sweeping immunity in the area of rates above fully-distributed costs. The NTP's directive to the Commission to "foster sound economic conditions in transportation and among the several carriers" gives the Commission an interest in carrier policy which will interact with managerial discretion at least as long as some movements, *e.g.*, rail passenger traffic, must be carried on at a net loss.

than the traffic will bear, that is, lower than the value of service, has been rejected by the Commission when considered in the light of the *New Haven* decision.[48]

The treatment accorded the *New Haven* decision in the recent ICC rulings seems to foreshadow both the future treatment of that decision as precedent in the Supreme Court and the probable importance of the decision for future ICC regulation of intermodal rate reduction controversies. As precedent, the decision's commentary on fully-distributed costs will probably be alternately invoked and ignored depending upon the reason of the case at hand. *New Haven* will surely be invoked for its distribution of emphasis among the conflicting mandates of the rule of ratemaking and its general commentary on destructive competition. As a force for change in the rulings of the ICC, *New Haven* seems to point the way toward a period of intensive but orderly competition which will tend to produce, not a rate structure which would permit all modes to participate, but "a rate structure which would reflect the relative economy and fitness of the competing modes of transportation," [49] and would deliver the benefit of that relative economy to shippers and consumers.[50]

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[48] Alcoholic Liquors from Maryland, New Jersey, New York and Pennsylvania to Florida, 319 I.C.C. 323 (1963); Alcoholic Liquors from New Hampshire and New York to Texas and Louisiana, 319 I.C.C. 396 (1963).

[49] Harbeson, *op. cit. supra* note 12, at 305.

[50] Readers who are interested in more extensive commentary on this topic should consult Nathanson, "Administration Proposals for Revision of Our National Transportation Policy—Herein of Intermodal Competition and the Minimum Rate Power," 58 Nw. U.L. Rev. 583 (1963). Part One of Professor Nathanson's excellent article investigates the standards underlying the Commission's use of the minimum rate power and includes a full discussion of *New Haven.*